

## **Electricity Market Reform**

### **DECC consultation 16<sup>th</sup> December 2010 – 10<sup>th</sup> March 2011.**

This submission is made by the Food and Drink Federation, the trade association for food and drink manufacturing. Food and drink is the largest manufacturing sector in the UK (about 15% of total manufacturing output) turning over almost £73bn per annum; creating GVA of around £22bn; employing around 440,000 people; and contributing around 2% of the UK's total GDP.

Our sector uses around 10 TWh of electricity per annum. We also use around 33 TWh of heat energy generated mainly from fossil fuel sources. In the coming decades, as ever tighter carbon budgets lead to a low carbon economy, we anticipate that a significant part of that heat demand will have to be met by the electrification of heat supply and that this electricity will be generated from low or zero carbon sources.

Our sector plays a key strategic role in respect of the nation's future food security and as the recent Foresight report on the Future of Food and Farming points out we are faced with the challenge of producing more food from fewer resources and with less impact on the environment. We therefore see sustainable food production as a key strategic priority for Government in its own right. We further see a low carbon electricity market in the UK that delivers supply security as, in turn, key to our sector helping deliver secure and sustainable food in the future.

We are, however, having to deal with these challenges in the face of an unprecedented combination of cost pressures, from global commodity price increases through to transport fuel and energy costs.

In this wider context we would like to offer the following comments in response to the Electricity Market Reform consultation

#### **Carbon Price Support**

We responded separately to the HM Treasury consultation on Carbon Price Support making two key points:

- The cumulative cost impact of climate change and energy policies need to be assessed to ensure the continued competitiveness of UK manufacturing industry in global markets. The impact of the Carbon Price Support is only one of number of cost impacts that need to be assessed.
- The Carbon Price Support should not be applied to fuel used in Combined Heat and Power plant. To do so will potentially close existing plant, prevent new plant coming on line and, therefore, increase emissions of greenhouse gases.

Further details are contained in that response.

## **Market Investment**

We are supportive of the long term aims of the Electricity Market Reform project of providing greater certainty to investors to deliver a low carbon electricity market and security of supply whilst at the same time being affordable to consumers.

We note the comments in the consultation document that, to date, the UK electricity market has provided affordable and secure energy since the 1990's. However, it is difficult not to observe that the current market arrangements have not so far provided the long term price, regulatory and investment signals needed to replace ageing nuclear capacity, to develop new capacity to replace coal generation (due to be phased out as a result of the Large Combustion Plant Directive) and to deliver further capacity to meet growing UK demand – whilst at the same time placing the electricity generating sector onto a path towards meeting UK carbon budgets and the 80% 2050 emissions reduction target. We understand it is the absence of a long term price signal that now necessitates the more interventionist approach advocated under the proposals in this review.

We recognise that consumers will ultimately pay for decarbonising electricity supply so we would wish to see a full Impact Assessment – covering all policies (e.g. CPS, CCL/CCAs, CRC, EUETS Phase 3, IED etc.) and not just those proposed under EMR – to ensure the burden on industry is minimised. A major concern of our members is the cumulative impact of climate change and energy regulation.

## **Price Impacts on food and drink manufacturers**

Our sector uses around 10 TWh of electricity per annum and we estimate that the additional cost to our sector of CPS will add £70m to £250m per annum to electricity bills (based on data in the consultation). These equate to the percentage ranges identified in the Impact Assessment of up to 6% price increases compared to baseline. Details in the EMR consultation documents, taking into account the additional impacts of capacity margins, contracts for difference and emissions performance standards, raise the impact to 7%-8% by 2025.

However, the analysis totally fails to address the cumulative impact of other climate change policies that impact our members and will essentially add further cost to energy bills over and above those identified here. These include purchasing additional allowances in the EU Emissions Trading Scheme from 2013 onwards and the impact of the yet to be resolved uncertainties surrounding the future of Climate Change Agreements, which provides a rebate to the Climate Change Levy, and the cost associated with the purchase of allowances under the Carbon Reduction Commitment. The cumulative impact of these policies on energy prices would, we estimate, be well over 25%.

Government needs to take into account the full impact of cumulative costs on manufacturing industry - particularly at a time when the Government Growth Review and the Advanced Manufacturing Review seeks to introduce the best conditions for business and private sector growth and to maintain the competitiveness of UK industry in global markets.

## **Feed in Tariffs**

We note that one aim of Contracts for Difference Feed in Tariffs/ Premium Feed in Tariffs is to provide greater revenue certainty to investors. In our response to HM Treasury on Carbon

Floor Price we noted that Contracts for Difference appear to be aimed at achieving the same outcome as Carbon Price Support i.e. to provide a financial incentive to support investment in new low carbon generation capacity and so questioned the need for both mechanisms. We also note that the costs of implementing both mechanisms would ultimately be borne by consumers.

However, FDF acknowledges that Feed in Tariffs could encourage and support investment in low carbon generation. Again, our main concern would be to see a regime that delivers the required outcome but is implemented at lowest cost to customers – noting the obvious point that tariffs under Contracts for Difference would need to be at a high level compared to the wholesale prices if they were to deliver the desired outcome! From the perspective of our members, who may in the future consider biomass/biogas CHP plant and who would therefore have the opportunity to export electricity into the grid, there are potential advantages in the Premium Feed in Tariff route which would give clearer price signals, provide less of a barrier to entrance and be easier to administer. One possible option which the Government should explore could be Contracts for Difference aimed at large scale technologies such as nuclear, off shore wind and CCS coal/gas and Premium Feed in Tariffs for other smaller scale technology.

### **Capacity Payments**

FDF recognises that a greater level of flexible generating reserve would be necessary when the overall generation mix contains a higher level less flexible capacity (nuclear) and intermittent (wind etc.) We also recognise that the provision of such capacity comes at a cost.

We see the merits in appropriately designed and targeted capacity payment mechanism to ensure continuity of supply – which would obviously be supported by a full cost assessment regarding the impact on consumer prices that values the provision of the reserve capacity

We are also aware of the possible options to achieve similar aims through demand reduction to help achieve short term balancing of supply and demand. All food and drink manufacturing plant needs electricity to operate and concerns that voluntary demand reduction would equate to stopping production of food and drink products that are often perishable and dependent on refrigeration and that are part of a wider highly integrated and interdependent food supply chain precludes this option being considered by most manufacturers. This is not to say that with greater awareness of the issues, the advent of a ‘smart grid’ and increased on-site generation being installed in the coming years that suitable opportunities for food and drink manufacturers to participate in demand side response could not be developed. FDF would be willing to discuss with DECC the best way to take this issue forward.



